Economic Outlook

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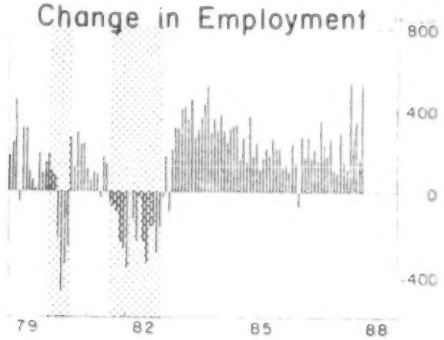
The surge in February employment has given the strongest signal to date that reports of the economic expansion's imminent demise are greatly exaggerated (see chart). Combined with the large upward revision in January payroll employment, the latest jobs data virtually assure that output continues to grow in 1988. The 5.7% unemployment rate is the lowest since the summer of 1979. And initial claims for unemployment insurance have returned to less worrisome levels after a sharp run-up in January.



Even before the employment numbers were released, economists had begun to rethink their outlooks for 1988. For example, the February survey of the National Association of Business Economists found only one in four respondents believing a recession would begin in 1988, down from about half of those surveyed in November, shortly after the stock market crash. With the stock market debacle now almost five months behind us, it is increasingly unlikely that its lingering effects will precipitate a recession. Instead, the crash has had the fortuitous effect of dampening inflationary expectations, paving the way for lower interest rates and a prolonged expansion.

Recent evidence from the economy suggests that the interest rate breather may be drawing to a close. In addition to the strong employment data, other indicators have reduced recession fears. The fourth-quarter buildup in auto inventories appears to be working down with little evidence of consumer weakness. One recent estimate placed GM inventories at a 59 days' supply in late February, Chrysler at 68 days, and Ford at 59 days compared with a desired level of roughly 65 days. This was down from 84 days, 101 days, and 70 days' supply a month earlier at GM, Chrysler, and Ford, respectively. Indeed, domestic automobile production schedules are already picking up and will contribute to faster economic growth in the second quarter. What inventory problems remain are largely confined to foreign models. Some Japanese producers continue to pile up inventories in the U.S. just to assure their quotas won't be reduced when the new Japanese fiscal year begins April 1.

Fourth-quarter GNP growth was revised up to 4.5% from the 4.2% rate initially reported. Upward adjustments in domestic demand accounted for most of the increase with significant upward revisions reported in consumer and business spending. Unfortunately, this included increased spending on imports, while exports were revised down. All in all, the changes showed less weakness in final sales than the preliminary report.

The only real signs of weakness that remain are in the building sector where housing starts, housing sales, and construction spending were all down in January. Construction employment also fell in January, but rebounded sharply in February, suggesting some of the January weakness was due to worse than usual weather in certain areas of the country. While this sector is likely to remain sluggish, the January numbers most likely overstate the problem.

There are some signs of moderating growth in the manufacturing sector. Employment gains in January and February were less than half the monthly average in the last several months of 1987. The manufacturing workweek and overtime measures declined, but remain relatively high by historical standards. The February Purchasing Managers' index slipped a bit, but still points to continued expansion. The growth in production was described as "strong" but "decidedly slower" than it was in the fourth quarter of 1987, when the index reached its highest levels. January new factory orders showed good strength after adjustment for the volatile transportation sector, and the backlog of unfilled orders is still rising.

In sum, the economy continues to defy the gloomsters. While there are incipient signs of moderating growth in the manufacturing sector, this is simply a slowdown from unsustainable levels. The overall economy remains healthy. Job growth is keeping consumer confidence at high levels. Recent employment gains have been especially strong in higher paying executive, managerial, and administrative jobs. The outlook remains favorable for good growth in 1988.

Robert T. McGee

Real GNP

(Percent Contribution to Real GNP Growth; Annual Rates)	Actual 1987				Forecast 1988				Actual 1986-	Forecast 1987-	Forecast 1988-
	I	II	III	IV	I	II	III	IV	1987	1988	1989
Consumer Spending	-0.5	1.2	3.5	-2.0	1.5	0.8	0.8	0.8	1.2	0.8	0.5
Business Investment	-1.9	1.3	2.8	-0.1	1.7	0.8	0.8	0.6	0.1	1.1	1.0
Residential Investment	-0.4	-0.2	-0.4	0.4	-0.1	-0.1	-0.1	-0.1	0.0	0.0	-0.2
Change in Inventories*	4.4	-1.6	-1.5	5.4	-2.2	0.5	0.4	0.3	0.5	0.3	0.0
Net Exports	1.8	0.3	-0.6	0.2	1.1	0.9	0.7	0.9	0.3	0.6	0.6
Government Purchases*	1.0	1.5	0.5	0.6	0.5	0.5	0.5	0.5	0.8	0.6	0.4
Real GNP	4.4	2.5	4.3	4.5	2.5	3.4	3.1	3.0	2.9	3.4	2.3

Quarterly Economic Indicators

(Percent Changes at Annual Rates)	Actual 1987				Forecast 1988				Actual 1986-	Forecast 1987-	Forecast 1988-
	I	II	III	IV	I	II	III	IV	1987	1988	1989
Nominal GNP	8.6	6.3	7.3	7.3	6.0	8.0	8.7	8.9	6.0	7.3	8.5
GNP Deflator	4.2	3.5	2.8	2.7	3.5	4.5	5.3	5.7	3.0	3.8	6.1
Corporate Profits After Tax#	6.7	10.0	9.0	6.3F	12.5	10.1	8.5	6.9	9.0	9.5	6.0

Monthly Economic Indicators

	Recent Data			Actual	Forecast	
	Dec.	Jan.	Feb.	1987	1988	1989
Consumer Price Index** (%)	0.1	0.3	n.a.	4.4	5.3	6.2
Industrial Production (%)	0.4	0.2	n.a.	3.7	5.1	2.7
Retail Sales (%)	1.2	0.5	n.a.	3.5	3.4	3.2
Auto Sales (million units, a.r.)	10.9	10.4	n.a.	10.3	9.8	8.8
Housing Starts (million units, a.r.)	1.40	1.38	n.a.	1.63	1.53	1.35
Unemployment Rate (%)	5.8	5.8	5.7	6.2	5.5	5.5
Merchandise Trade Balance ($ bn., a.r.)	-146.4	n.a.	n.a.	-171.2	-145.0	-110.0

*Adjusted for CCC purchases. **Annual percent changes are December to December. March 8, 1988
#Quarterly data are year-over-year percent changes. F = Forecast
a.r. = annual rate